Chinese dialogue

Reforms are going hand in hand with a fresh look at corporate values, M&A expert LI QIANG tells the *Brunswick Review*

For multinational corporations, the road to success in China is fraught with cultural and structural complications. Li Qiang, Managing Partner of law firm O'Melveny & Myers' Shanghai office and a member of its mergers and acquisitions practice, says the environment is beginning to change for the better under a reform-minded government. Chinese businesses are even starting to look to Western corporate values as a model. The Shanghai Free Trade Zone is the key, and could eventually influence national corporate governance, becoming the "Delaware of China," he says.

How is the business climate in China changing for foreign companies?
The investment environment is, in general, improving in China. But people also need to be aware that China is basically in transition. The new government is quite serious about transforming a top-down, investment-driven economy to a more bottom-up, consumption-driven economy. They haven't found the solution yet, but the determination is quite impressive.

Foreign companies have faced harsh treatment on compliance issues from the National Development and Reform Commission, the top economic planning agency. Is that over now?
We have been getting conflicting signals from regulators. A reshuffling in the administration means some offices will probably lose some power. The NDRC's heavy-handed approach with some multinational companies may reflect →

a sense of insecurity amid the reforms because its role will probably be diminished. Unfortunately, multinational companies will have to continue to deal with that.

How do Chinese companies view compliance?

A couple of years ago, if you were to make an investment in a Chinese company and tried to do your due diligence or include anti-corruption provisions in the contract, you would encounter a lot of resistance. Chinese companies would say, "Ugh, you guys, imposing US business values, that's very arrogant and imperialist." But nowadays, we hardly get that kind of resistance at all.

We have multinational clients with very robust compliance programs. They have high corporate governance standards and don't compromise their values when they come to China. The Chinese are starting to look at that as something that carries prestige and tangible value. They are actually putting a price tag on it.

Traditionally, corporate governance has not been seen as a priority for companies in China. Is that changing?

There is a growing consciousness. Chinese companies are subject to a backward-looking body of corporate governance rules. They have very arcane mechanisms. The mindset is that without set values, you have to rely on the guy in the company who can control the "chop," its official legal stamp – "That guy, we need his signature."

What would you emphasize to multinationals coming in?

Understand the corporate governance rules and how they differ from what you're used to. Don't assume things like fiduciary responsibility apply here.

Companies doing business in China need to resort to suitable controls, such as holding the chop, escrow mechanisms to safeguard funds, keeping board seats or having veto rights over certain things. Sometimes people

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cede those control mechanisms too easily, assuming the people they deal with are the same kind of directors and managers as in their home countries. But they may be very different. They probably don't look at things the same way you do.

You mentioned a sense of insecurity in some government departments. Is the reform effort poking some dragons?

Well remember that, historically, Chinese people hate reformers. Shang Yang, a reformer who lived 2,400 years ago, was executed.

But seriously, there is motivation for reform?

A big driver for the reform of corporate governance is the Social Security Fund. It's losing money because it has no place to invest in China. The capital markets are in shambles. The motivation for financial reform in China has to come from within, and I think one place where that might start is with the Social Security Fund. The Chinese populace, the vast majority, really relies on social security.

How do you see the next two years unfolding for multinationals?

I think the environment will steadily improve. Partly because, as corporate governance improves, the people who foreign companies deal with are going to be more reliable, more legitimate business partners, in the government and business.

And that's changing already?

It's changing quite rapidly, even in private Chinese companies, although they still have a long way to go. When a company is dominated by a small number of principals, or just one, it creates a climate where lower level people don't feel they have much of a stake. They may then do deals that benefit them personally because there's no incentive to serve the business. That's due to poor governance. And that lack of a stake leads to high turnover and the loss of institutional knowledge – over and over. But incentive structures are a growing priority now.

What kind of incentives do Chinese employees really value?

I would say mentoring. Not only do companies enjoy the benefits of employees who are engaged with the business, it is also very important that when those employees leave, they do so on good terms. And it happens a lot in this economy – people are moving around. With mentoring, you're helping to grow stability and build the next generation of business leaders. Even if they don't stay, they might be your future business partners or supporters in your ecosystem.

Should foreign companies communicate their values?

Yes. Having a strong corporate culture – that sells in China. Take mentoring.

ILLUSTRATION: STUART DALY

What Chinese company has it? Even some multinationals don't have mentoring. But it really is valued by the younger generation of Chinese. And as I say, the Chinese are changing their thinking about values. China has a long history of prizing virtue. But corporate values are more of a Western concept. So there's a translation problem. But now that concept of corporate values as a virtue is starting to take hold.

Who should foreign companies approach when entering the Chinese market?

Think local. In that sense, China is pretty much like the rest of the world. In the US, you would go to the mayors, because a mayor really wants to develop local business. In China, don't go to the center, to Beijing. Going local in China means going to places such as the Shanghai Free Trade Zone. The government wants foreign companies there. Officials will assemble all the right folks, a relevant mix of people with a lot of interest in what you're doing, and bring them to a meeting. They'll say, "What can we do to help you, to make you comfortable setting up here?" These investor-friendly events occur at the local level, not national.

Are there already big advantages for multinationals in the Shanghai FTZ?

No, it's still early days, but the intent is there. I think the sea change will come if the Shanghai FTZ can become like Delaware in the US, successful because it's so business friendly. And it's not just Shanghai – there will be others. We are probably going to see these free trade zones develop into "mini Hong Kongs" or "mini Dubais." They will be shining examples for the rest of China.

The mythological *fenghuang* bird first appeared on Chinese artifacts more than 7,000 years ago. Sometimes called the Chinese phoenix, it is an auspicious symbol that represents virtue, grace and justice. Originally two birds, *feng*, male, and *huang*, female, the combined symbol balances the two, in the manner of *yin* and *yang*

Pick a few places and concentrate on modern governance, make sure they succeed, and the rest of China will follow suit. If it catches on, it could become an avalanche.

Does having a presence in the FTZ make sense for a business coming into China, but not necessarily to Shanghai?

It does. In terms of foreign exchange, FTZ-based companies have more flexibility in deploying their offshore renminbi or US dollars in other parts of China, so the rules are clearly beneficial. But to me, that's still a technical liberalization. If corporate governance can be promoted in Shanghai, a lot of companies will want to register in the FTZ anyway as a platform for investments in other parts of China.

Meanwhile, what's the best advice for dealing with the Chinese government?

The government is ubiquitous. How do you strike a balance in your dealings with them? How do you make sure that you're seen to create value for them? It needs to be a win-win relationship.

One mistake that foreign companies often make is that they feel they always have to say "yes." Say "no" sometimes, and explain why. Push back. You can even sue the government. Don't assume the government will be completely impossible. You can have a dialogue. Be part of the solution.

Finally, don't forget your values. Translate that into virtue. This is the perfect time for that. We are seeing an era of recontracting between multinationals and the Chinese government. The experience shouldn't be about kowtowing to officials and then feeling beat up. I'm hopeful that's changing. It is becoming a much more even-handed relationship.

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DOING BUSINESS IN CHINA

GOVERNANCE
Understand local rules and keep veto rights, escrow mechanisms, board seats and other controls

MENTORING
Young Chinese workers increasingly see the value in a strong corporate culture

WIN-WIN
Show government leaders how your company can be valuable to them

DIALOGUE
Seek a dialogue with the government and don't be afraid to say "no"

VALUES
Don't sacrifice your corporate values – they can be an important selling point